The Limits of “Friend-Shoring”

By Emily Benson and Ethan B. Kapstein

Speaking in April 2022, Secretary of the Treasury Janet Yellen announced the Biden administration’s new approach to navigating a more contentious global economy, calling it “friend-shoring.” Speaking at the Atlantic Council, Yellen said: “We cannot allow countries to use their market position in key raw materials, technologies, or products to have the power to disrupt our economy or exercise unwanted geopolitical leverage. Let’s build on and deepen economic integration. . . . with the countries we know we can count on.”

But is “friend-shoring” really a panacea? After all, even military allies can be fierce economic competitors. Further, to what extent is dependence on a “friend” that reliable? In that regard, the U.S. maintains a dependence on Taiwan—certainly a friend—for semiconductor chips.

This paper addresses the prospects for friend-shoring, with a focus on U.S.-EU economic relations. It discusses some of the challenges that the enactment of a friend-shoring policy would face and analyzes one of the key institutional developments associated with this new approach to economic cooperation, namely the U.S.-EU Trade and Technology Council (TTC), which held its third ministerial meeting in December 2022. Indeed, the TTC is already being called “the new ‘friend-shoring’ vehicle.” While the TTC is undoubtedly seeking to harmonize U.S.-EU regulatory policy in some key issue areas, its limitations are no less suggestive of the impediments to deeper cooperative engagement. This paper seeks to provide a balanced assessment of the friend-shoring idea.

Would Friends Friend-Shore?

In her April 2022 speech, Yellen emphasized the role of “trusted partners” in her scheme for addressing the so-called vulnerabilities associated with modern, far-flung supply chains. To students of international relations, the phrase “trusted partners” will ring hollow. As Princeton’s Harold James put it in an editorial written shortly after Secretary Yellen’s address: “Identifying one’s international friends will always be a problematic exercise,” evoking British prime minister and statesman
Lord Palmerston’s famous line that “we have no eternal allies, and we have no perpetual enemies. Our interests are eternal and perpetual, and those interests it is our duty to follow.” Even within the European Union, for example, the United States might reasonably have qualms about friend-shoring to such countries as Hungary, which Freedom House ranks as only “partly free.”

Similarly, Europeans have had doubts about their economic relationship with the United States throughout the post-World War II era, as exemplified by Jean-Jacques Servan-Schrieber’s 1967 bestseller, The American Challenge. More recently, during the Trump administration, the European Union faced high tariffs and great uncertainty about the future trajectory of U.S. trade policy. Unfortunately, the Biden administration’s determination to pursue a robust industrial policy at home, loaded with billions of dollars in subsidies so that the United States can “build back better,” has provoked European ire and resentment.

Even if one could finesse the political issues associated with friend-shoring, the economics are even more unattractive, particularly for international development. First, as Raghuram Rajan points out, friend-shoring could “have devastating effects on international trade” to the extent that “non-aligned” developing countries are left out of the friend-shoring orbit. Many developing countries have not adopted U.S. sanctions policies toward Russia (or China for that matter), preferring to trade as widely as possible. Second, to the extent that friend-shoring requires costly industrial policies, including the use of subsidies and tax breaks, it will likely lead to higher consumer prices and less efficient (and productive) firms. Overall, friend-shoring is not a recipe for global economic growth.

The U.S.-EU Trade and Technology Council

Strengthening U.S.-EU economic ties, including more trade and investment, is a good thing that should be promoted. In that regard, new institutions that help reduce transatlantic frictions may be helpful in reassuring investors about the potential for a “level playing field” where they can operate with reduced transaction costs. One such institution, focusing largely on the tech sector, is the TTC.

In September 2021, the United States and European Union held the TTC’s inaugural ministerial summit. This new initiative is divided into 10 working groups aimed at specific policy arenas, from governance of artificial intelligence (AI) to climate change mitigation efforts. The core objective of this transatlantic endeavor is not to address many of the outstanding bilateral trade issues that have imperiled past negotiations, but rather to discuss emerging policy areas where the parties can achieve tangible progress in establishing common norms and, perhaps, regulations. The parties have since convened in May 2022 for a second ministerial, a third ministerial in December 2022 in Washington, D.C., and will meet again in Sweden in the spring of 2023.

One of the long-standing issues that has historically confronted the allies as they pursue deeper cooperation is the fundamentally different way in which the United States and the European Union approach regulation. The United States tends to take a largely ex post approach to regulation, which aims to address problems that have already emerged in a given sector, while the EU approach is prescriptive and ex ante, emphasizing the “precautionary principle,” which seeks to limit the introduction of new innovations whose socioeconomic and environmental impacts are poorly understood. This difference in regulatory philosophy has complicated transatlantic negotiations for over 30 years on a wide variety of issues, including agriculture, where many EU states remain vehemently opposed to the introduction of genetically modified crops.
A key area in which the European Union and United States remain divided concerns digital regulation and competition. The United States has thus far opted against using the TTC as a forum for voicing concerns about the European Union’s ambitious digital legislation packages, which include the **Digital Services Act** (DSA), the European Union’s sweeping platform regulation, and the **Digital Markets Act** (DMA), the European Union’s antitrust package that regulates large U.S. technology firms. Thus, any advances the TTC makes in such “cutting-edge” areas as governance of AI may be undermined by the lack of agreement on such key topics as privacy, antitrust, and other areas that could promote “splinterization” rather than harmonization.

**Key TTC Themes**

Despite these differences, several of the TTC working groups are engaged in discussions that could significantly enhance transatlantic economic cooperation. Regarding friend-shoring specifically, **the joint statement from the May 2022 TTC ministerial** underscores the need to build more geographically and commercially diversified supply chains and directly highlights an overdependence on China for the production and processing of certain inputs and goods. Relatedly, the TTC’s Working Group 4 on ICT Security and Competitiveness is tasked with ensuring security, interoperability, and resilience across the information and communications technology (ICT) supply chain. This includes critical areas such as 5G supply chains; undersea cables, which facilitate 99 percent of transatlantic data transfers; and cloud infrastructure. This working group also has a task force dedicated to promoting the use of trusted ICT suppliers in third countries, which in turn bolsters the security and competitiveness of firms on both sides of the Atlantic.

In addition to these ICT issues, the parties also agreed at the May 2022 ministerial to establish an early warning alert system that would facilitate information sharing about potential disruptions to semiconductor supply chains. Encouraging greater transparency in supply chains, particularly within the semiconductor sector, has been challenging due to ongoing private sector reluctance on both sides of the Atlantic to share sourcing information with governments and industry competitors. Thus, while efforts to cooperate on supply chain transparency are welcome, concrete outcomes may yet prove elusive without more private sector buy-in.

Several of the TTC working groups focus on emerging technology issues. At the May 2022 ministerial, the European Union and United States reaffirmed their support for an internet that is open, global, interoperable, reliable, and secure, in line with the **Declaration for the Future of the Internet** and the **Declaration on Digital Rights and Principles for the Digital Age**. Working Group 6, which deals with misuse of technology and human rights concerns, is tasked with combating unlawful surveillance and protecting freedom online, policies that are being designed in conjunction with the G7 and other likeminded countries. This group is also tasked with cooperating on foreign interference and digital manipulation, including combating the proliferation of disinformation. Whether the parties will be able to move beyond generalized statements of principles and toward tangible outcomes depends on their ability to promulgate joint standards as well as to enforce them.

Another evolving question at the heart of the transatlantic economic relationship is the degree to which the United States and European Union will be able to avoid a subsidy race and to align their industrial policies. The long-standing “allergy” to industrial policy seems to be subsiding, with both sides
considering increasingly aggressive means of spurring domestic production, whether on green goods or advanced technologies. Examples include the recent chips package that the U.S. Congress passed, the equivalent proposal in the European Union, and the electric vehicle tax credit contained in the U.S. Inflation Reduction Act (IRA). As a recent CSIS commentary notes, “In effect, the United States and the European Union have proposed a coordinated implementation of industrial policies in a vital strategic sector involving massive public outlays on both sides of the Atlantic—an unprecedented development in postwar transatlantic relations.”

The electric vehicle (EV) tax credit, however, has invited fierce diplomatic backlash from Brussels, which regards incentives in the IRA as directly intended to “hoover up” EU industry in an already precarious economic environment. Both sides have sought to keep the EV tax credit out of the TTC, although lackluster results from the latest ministerial underscore the extent to which U.S. domestic content incentives have cooled transatlantic cooperation. Nevertheless, transparent implementation of transatlantic packages can help the transatlantic alliance consolidate economic power while maintaining a technological edge over strategic competitors.

**Convergence on Export Controls**

The flip side of friend-shoring is denying economic opportunities to the enemy by promoting, for example, export controls. The Russian invasion of Ukraine in February 2022 promoted transatlantic cooperation in this area. The relevant TTC working group on export controls has been credited with facilitating the international response on export controls, which 38 countries have joined. Designing an effective sanctions and export control regime and diluting the effects of this abrupt decoupling on the European economy have become core tasks of negotiators on both sides of the Atlantic.

Beyond depriving Russia’s war machine of the ability to access technology with military applications, the U.S.-EU promulgation of export controls is deeply interlinked with long-term transatlantic geopolitical strategy and can directly affect the economic health of advanced technology industries on both sides of the Atlantic. Export controls are an important trade tool that can be used to manage international flows of technology, determining which countries have access to critical technologies with military applications.

Within the transatlantic context, the United States has a much more robust history of promulgating export control policy, dating to the U.S. Export Control Act of 1949, which authorized the president to restrict the export of war materials. The International Emergency Economic Powers Act (IPEEPA), originally passed in 1977 but amended several times in ensuing years, also grants the president sweeping authority to pursue trade and wield economic tools to restrain the economies of foreign adversaries while also dampening their ability to develop next-generation technology with military applications. In 2018, Congress passed the Export Control Reform Act of 2018 (ECRA), which enhanced government capabilities to review both foreign investments and domestic outflows and comprehensively updated U.S. export control provisions.

In the European Union, on the other hand, export controls and regulatory control over investment flows have historically been the remit of member states. Only in 2009 did the European Union lay the foundations for a more consolidated system for governing dual-use exports. European Commission authority over export controls was significantly expanded in 2021 through the EU Dual-Use Regulation, which further consolidated authority over export controls and made the licensing program more transparent.
The two parties have historically taken a cooperative but somewhat different approach to export controls, explained in part by the differing level of federal capabilities in each jurisdiction. Given the stronger institutional history of export control capabilities in the United States, the European Union has looked to the U.S. Department of Commerce for intelligence on possible Russian circumvention as well as assistance in carrying out export control enforcement. The TTC has so far succeeded in facilitating the transfer of institutional knowledge and capabilities, although it remains to be seen whether a more concrete structure, such as a supplement for the Wassenaar Arrangement, will emerge from the TTC.

Exemplifying the fine line that policymakers walk when determining export control policy and also the persistence of different approaches to security and trade policy, the Biden administration has recently sought to curb Dutch exports of deep ultraviolet (DUV) lithography equipment from ASML, a Dutch semiconductor manufacturer, to China. The Netherlands regards this push by the United States as an acceleration and expansion of export controls that have not previously applied to last-generation technologies, which the Chinese have been able to acquire legally in recent years. Too broad an application of export controls could dampen profits, thereby depriving companies of profits they need to research and develop next-generation technology and maintain a competitive edge over adversaries. However, in a September 2022 speech, National Security Advisor Jake Sullivan publicly highlighted a fundamental shift in the U.S. approach to export controls, which goes beyond delaying adversaries’ technological capabilities to degrading them. Reducing the economic costs of this broadened application of controls will be important for transatlantic partners to address.

The export controls on Russia, which the United States and European Union have carried out in close concert with other key allies such as Japan and South Korea, have begun to bite. In August 2022, for example, it was reported that Russia was scrapping commercial airliners for spare parts to use in military applications. Furthermore, it is clear that the Russian invasion of Ukraine has succeeded in significantly accelerating transatlantic cooperation on export controls. It remains unclear, however, whether this same level of transatlantic enthusiasm would carry over in the case of a possible Chinese incursion into Taiwan, particularly as the United States shifts from a policy of delaying foreign military capabilities to one of degrading them.

**Friend-Shoring: Limits and Opportunities**

As the architects of the post–World War II world order, the European Union and United States have a renewed opportunity to build a trade and technology architecture for coming generations. The Russian invasion of Ukraine and mounting tensions with China have further solidified the transatlantic alliance and underscored the urgency of designing innovative policy responses to pressing issues such as the Russian invasion of Ukraine, the United States and European Union’s declining global share of semiconductor production, and the need for new mechanisms to govern machine learning.

The TTC has already succeeded in consolidating transatlantic cooperation. It has facilitated a historic level of collaboration between diplomats on both sides of the Atlantic and has opened channels that have enabled the parties to respond swiftly and adroitly to emerging threats. The mere existence of the TTC is a coup for EU and U.S. diplomats and underscores the fresh enthusiasm for greater cooperation after a period of tumultuous relations.
While transatlantic geopolitical authority seems to have consolidated considerably in recent months, it remains to be seen whether emerging differences represent long-term fissures that could grow or whether these are temporary disagreements that external factors will make obsolete. The potential design and implementation of an outbound investment screening mechanism in the United States could risk ensnaring EU investments as bycatch in an otherwise unilateral push by the United States to control adversaries through the accelerated injection of security concerns into economic and trade policy.

For example, key U.S. leaders, including in Congress and the White House, have been enthusiastic about the design and implementation of an outbound investment screening mechanism, which would duplicate export control authority to screen investments going to critical industries in “countries of concern.” Although this language was recently left out of the China competition legislative package, bipartisan, bicameral members of Congress have recently called on the White House to pursue an executive order that would establish an outbound investment review mechanism. This approach in the United States could cause a potential fissure in the transatlantic relationship, and the European Union remains reluctant to become “collateral damage” in the United States’ attempt to degrade China’s military capabilities and is contemplating the creation of its own comparable tool.

Despite differences in key policy areas, the TTC could become a blueprint for cooperation, bypassing the potential “splinterization” of the digital economy and transatlantic technology ecosystem in favor of multilateralization of standards and policies that more firmly cement transatlantic leadership into the twenty-first century. Working toward commitments that are durable and binding will increase the likelihood that this diplomatic framework is institutionalized over time.

For now, however, transatlantic leaders must demonstrate their ability to effectuate tangible outcomes if friend-shoring is to go beyond mere policy rhetoric. In that context, it would be useful for them to recall that this has been a long-term objective of the Western alliance. As the 1949 North Atlantic Treaty notes: “The Parties . . . will seek to eliminate conflict in their international economic policies and will encourage economic collaboration between any or all of them.”

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